

CITY OF BALTIMORE
WATER UTILITY FUND
FINANCIAL STATEMENTS
FOR THE YEARS ENDED
JUNE 30, 2008 AND 2007
(WITH REPORT OF INDEPENDENT AUDITORS THEREON)

CITY OF BALTIMORE
WATER UTILITY FUND
FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2008 AND 2007

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CITY OF BALTIMORE

SHEILA DIXON, Mayor



DEPARTMENT OF AUDITS

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Report of Independent Auditors

December 23, 2008

The Mayor, City Council, Comptroller and
Board of Estimates of the City of Baltimore, Maryland

We have jointly audited the accompanying financial statements of the Water Utility Fund of the City of Baltimore, Maryland, as of and for the years ended June 30, 2008 and 2007, as listed in the table of contents. These financial statements are the responsibility of the City of Baltimore, Maryland's management. Our responsibility is to express an opinion on these financial statements based on our audits.

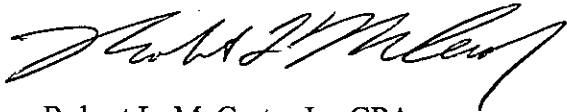
We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Water Utility Fund's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Water Utility Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Water Utility Fund and do not purport to, and do not present fairly, the financial position of the City of Baltimore, Maryland, as of June 30, 2008 and 2007, the changes in its financial position, or, where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water Utility Fund of the City of Baltimore, Maryland, as of June 30, 2008 and 2007, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.



The management's discussion and analysis on pages 3 through 6 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Robert L. McCarty, Jr., CPA
City Auditor
Department of Audits



Ernst & Young LLP
Independent Auditors

City of Baltimore Water Utility Fund

Management's Discussion and Analysis

This section of the City of Baltimore, Maryland's Water Utility Fund (Water Utility) financial statements presents our discussion and analysis of the Water Utility's financial performance during the years ended June 30, 2008 and 2007.

Background

The Water Utility supplies water to the City, as well as to portions of Baltimore, Anne Arundel, Carroll, Harford, and Howard Counties. The Water Utility serves over 1,800,000 people by supplying approximately 93 billion gallons of water annually. Approximately 51% of the Water Utility's customers and 42% of water usage are currently within the City, with the remaining 49% of customers and 58% of water usage being in the surrounding Maryland counties.

Highlights

- For fiscal year 2008, total operating revenues were \$131.2 million, which represents an increase of 1.8% above the previous year's revenues. For fiscal year 2007, total operating revenues were \$111.1 million, which represented an increase of 1.5% above the previous year's revenues.
- Total operating expenses for fiscal year 2008 were \$95.9 million, an increase of \$2.5 million over fiscal year 2007 operating expenses of \$93.4 million. Total operating expenses for fiscal year 2007 were \$93.4 million, an increase of \$5.1 million over fiscal year 2006 operating expenses of \$88.3 million.
- Net assets increased in fiscal years 2008, 2007, and 2006, by \$41.0 million, \$34.3 million, and \$46.1 million, respectively.

Overview of the Financial Statements

This report consists of three parts: 1) management's discussion and analysis (this section), 2) financial statements, and 3) notes to the financial statements.

The financial statements provide both long-term and short-term information about the Water Utility's overall financial status. The notes to the financial statements explain some of the financial information in the financial statements and provide more detailed information.

The Water Utility's financial statements are prepared in conformity with accounting principles generally accepted in the United States as applied to governmental units on an

accrual basis. Under this basis, revenues are recognized in the period in which they are earned, expenses are recognized in the period in which they are incurred, and depreciation of assets is recognized in the statement of revenues, expenses, and changes in fund net assets. All assets and liabilities associated with the operation of the Water Utility are included in the statement of net assets.

Financial Analysis of the Water Utility

Statements of Net Assets Water Utility Fund (Expressed in Thousands)

	<u>2008</u>	<u>June 30, 2007</u>	<u>2006</u>	<u>Change 2008-2007</u>	<u>Change 2007-2006</u>
Current and other assets	\$ 214,373	\$ 199,976	\$ 179,317	\$ 14,397	\$ 20,659
Capital assets	771,914	728,290	669,470	43,624	58,820
Total assets	986,287	928,266	848,787	58,021	79,479
Current liabilities	29,891	36,778	29,336	(6,887)	7,442
Noncurrent liabilities	441,526	417,602	379,893	23,924	37,709
Total liabilities	471,417	454,380	409,229	17,037	45,151
Net assets:					
Invested in capital assets, net of related debt	332,984	308,861	288,216	24,123	20,645
Restricted	68,030	103,168	94,321	(35,138)	8,847
Unrestricted	113,856	61,857	57,021	51,999	4,836
Total net assets	\$ 514,870	\$ 473,886	\$ 439,558	\$ 40,984	\$ 34,328

Analysis of the Statements of Net Assets

Net assets may serve as a useful indicator of the Water Utility's financial position. For the Water Utility, assets exceeded liabilities by \$514.9 million, \$473.9 million, and \$439.6 million in fiscal years 2008, 2007, and 2006, respectively. The Water Utility's net assets include its investment of \$332.9 million, \$308.9 million, and \$288.2 million in capital assets (e.g., land, buildings, and equipment), less any related outstanding debt used to acquire those assets, at the end of fiscal years 2008, 2007, and 2006, respectively. The Water Utility uses these capital assets to provide water services to citizens; consequently, these assets are not available for future spending. Although the Water Utility's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from customers of the Water Utility through rates and charges, since the capital assets themselves cannot be liquidated for these liabilities. An additional portion of the Water Utility's net assets, \$68.1 million, represents restricted resources that are legally obligated for the acquisition and improvement of capital facilities and revenue bond repayment requirements. The Water Utility had unrestricted net assets of \$113.9 million, \$61.9 million, and \$57.0 million as of June 30, 2008, 2007, and 2006, respectively.

During fiscal years 2008, 2007, and 2006, the Water Utility expended \$55.3 million, \$69.6 million, and \$62.0 million for capital assets. These assets primarily represent expenditures for facility enhancements to comply with environmental regulations. The assets were funded primarily through new issues of revenue bonds of \$27.2 million, \$41.8 million, and \$26.7 million in fiscal years 2008, 2007, and 2006, respectively. Fitch Ratings, Moody's Investor Services, Inc., and Standard & Poor's Rating Services gave the Series 2008 Bonds insured ratings of AAA, Aaa, and AAA, respectively.

Statements of Revenues, Expenses, and Changes in Fund Net Assets
Water Utility Fund
(Expressed in Thousands)

	Year Ended June 30,			Change	Change
	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2008-2007</u>	<u>2007-2006</u>
Operating revenues	\$ 131,233	\$ 111,052	\$ 109,471	\$ 20,181	\$ 1,581
Operating expenses:					
Salaries and wages	30,323	27,250	26,387	3,073	863
Other personnel costs	11,947	10,603	10,268	1,344	335
Contractual services	36,498	37,559	33,975	(1,061)	3,584
Material and supplies	5,455	6,310	7,136	(855)	(826)
Depreciation	11,686	11,634	10,544	52	1,090
Total operating expenses	95,909	93,356	88,310	2,553	5,046
Operating income	35,324	17,696	21,161	17,628	(3,465)
Non-operating income (expense)	(8,199)	(6,528)	(8,317)	(1,671)	1,789
Income before capital contributions	27,125	11,168	12,844	15,957	(1,676)
Capital contributions	13,859	23,160	33,291	(9,301)	(10,131)
Change in net assets	40,984	34,328	46,135	\$ 6,656	\$ (11,807)
Beginning net assets (as restated)	473,886	439,558	393,423		
Ending net assets	<u>\$ 514,870</u>	<u>\$ 473,886</u>	<u>\$ 439,558</u>		

Analysis of the Statements of Revenues, Expenses, and Changes in Fund Net Assets

The overall increase in the Water Utility's net assets amounted to \$41.0 million, \$34.3 million, and \$46.1 million for fiscal years 2008, 2007, and 2006 respectively, due to the implementation of a 4% water rate increase in fiscal year 2008, and a 9% water rate increases in both fiscal years 2007 and 2006, to customers located in Baltimore City, Anne Arundel, Howard, and Carroll Counties, successfully minimizing increases in operating expenses, and capital contributions, primarily from Baltimore County, corresponding to increases in the cost of the Capital Improvement Program.

Capital Assets

The Water Utility's capital assets as of June 30, 2008, 2007, and 2006 amounted to \$771.9 million, \$728.3 million, and \$669.4 million (net of accumulated depreciation), respectively. Capital assets include land, equipment, buildings, and improvements. Total increases in the Water Utility's net capital assets for fiscal years 2008, 2007, and 2006 were \$43.6 million, \$58.8 million, and \$75.0 million, respectively. These increases were funded primarily by issuance of revenue bonds. The following schedule presents the capital asset activities for fiscal years 2008, 2007, and 2006 (amounts expressed in thousands):

	Balance June 30, 2008	Net Change	Balance June 30, 2007	Net Change	Balance June 30, 2006
Land	\$ 12,540		\$ 12,540		\$ 12,540
Buildings and improvements	330,037	\$ (9,829)	339,866	\$(8,958)	348,824
Equipment	11,579	275	11,304	(658)	11,962
Construction in progress	417,758	53,178	364,580	68,436	296,144
Total capital assets, net	<u>\$ 771,914</u>	<u>\$ 43,624</u>	<u>\$ 728,290</u>	<u>\$ 58,820</u>	<u>\$ 669,470</u>

As of June 30, 2008, the Water Utility had commitments of \$52.2 million for the acquisition and construction of capital assets. See Note 6 for further information.

Debt Administration

For fiscal years 2008, 2007, and 2006, the Water Utility had long-term obligations of \$443.1 million, \$419.4 million, and \$381.3 million, respectively. These long-term obligations consisted primarily of revenue bonds, which are secured by revenue from the sale of water. The Water Utility also issued \$27.2 million in revenue bonds to finance the cost of capital acquisition and construction. During fiscal years 2008, 2007, and 2006, the Water Utility's debt increased by \$23.7 million, \$38.1 million, and \$23.9 million, respectively. See Note 7 for further information.

Economic Condition of the Water Utility

The Water Utility is a large regional utility system that provides service to the diverse Baltimore metropolitan area, which includes Baltimore City as well as portions of Baltimore, Anne Arundel, Howard, Carroll, and Harford counties. Modest growth is expected in the future. The Water Utility's long-term water supply is good, with water primarily coming from the Loch Raven, Prettyboy, and Liberty Reservoirs. Additional water can be drawn from the Susquehanna River, providing the Water Utility with additional capacity. Although the Water Utility is expected to make substantial investments in capital improvements to meet the Safe Drinking Water Act requirements and to rehabilitate aging infrastructure, management expects continued good financial performance, including adequate debt service coverage and liquidity. On May 28, 2008, the City Board of Estimates approved a 4% annual rate increase for Baltimore City and Anne Arundel, Howard, and Carroll counties effective May 29, 2008. Increased costs of water service are passed along to the counties under the terms of agreements with Baltimore and Harford counties.

CITY OF BALTIMORE
Water Utility Fund
Statements of Net Assets
June 30, 2008 and June 30, 2007
(Expressed in Thousands)

Assets:	<u>2008</u>	<u>2007</u>
Current assets:		
Cash and cash equivalents.....	\$ 58,536	\$ 54,730
Accounts receivable, net:		
Service billings.....	40,757	33,743
Due from other governments.....	1,259	
Inventories.....	4,760	4,669
Current restricted assets:		
Cash and cash equivalents.....	101,609	91,237
Investments.....		4,277
Accounts receivable, net.....	3,592	7,653
Total current assets.....	<u>210,513</u>	<u>196,309</u>
Noncurrent assets:		
Capital assets not being depreciated.....	430,298	377,120
Capital assets, net of accumulated depreciation	341,616	351,170
Unamortized bond issuance costs.....	3,860	3,667
Total noncurrent assets.....	<u>775,774</u>	<u>731,957</u>
Total assets.....	<u>986,287</u>	<u>928,266</u>
Liabilities:		
Current liabilities:		
Accounts payable and accrued liabilities.....	2,855	2,809
Accrued interest payable.....	5,364	4,762
Deposit subject to refund.....	15	15
Due to other funds.....		7,000
Due to other governments.....	3,391	1,424
Compensated absences.....	3,720	3,719
Revenue bonds payable.....	3,273	3,119
Accounts payable from restricted assets.....	11,273	13,930
Total current liabilities.....	<u>29,891</u>	<u>36,778</u>
Noncurrent liabilities:		
Revenue bonds payable, net.....	438,961	415,454
Compensated absences and other liabilities.....	1,668	1,293
General long-term debt payable.....	897	855
Total noncurrent liabilities.....	<u>441,526</u>	<u>417,602</u>
Total liabilities.....	<u>471,417</u>	<u>454,380</u>
Net assets:		
Invested in capital assets, net of related debt.....	332,984	308,861
Restricted for:		
Debt service.....	40,961	37,784
Future capital additions	27,069	65,384
Unrestricted.....	113,856	61,857
Total net assets.....	<u>\$ 514,870</u>	<u>\$ 473,886</u>

The notes to the financial statements are an integral part of this statement.

CITY OF BALTIMORE
Water Utility Fund
Statements of Revenues, Expenses, and Changes in Fund Net Assets
For the Years Ended June 30, 2008 and June 30, 2007
(Expressed in Thousands)

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Water service (net of bad debts of \$620 for fiscal year 2008 and \$835 for fiscal year 2007)	\$ 131,233	\$ 111,052
Operating expenses:		
Salaries and wages.....	30,323	27,250
Other personnel costs.....	11,947	10,603
Contractual services.....	36,498	37,559
Materials and supplies.....	5,455	6,310
Depreciation.....	11,686	11,634
Total operating expenses.....	<u>95,909</u>	<u>93,356</u>
Operating income	<u>35,324</u>	<u>17,696</u>
Nonoperating revenues (expenses):		
Loss on sale of investments		(231)
Investment income	3,049	5,766
Interest expense	(11,248)	(12,063)
Total nonoperating expenses	<u>(8,199)</u>	<u>(6,528)</u>
Income before capital contributions	27,125	11,168
Capital contributions.....	13,859	23,160
Changes in net assets.....	40,984	34,328
Total net assets - beginning	473,886	439,558
Total net assets - ending.....	<u>\$ 514,870</u>	<u>\$ 473,886</u>

The notes to the financial statements are an integral part of this statement.

CITY OF BALTIMORE
Water Utility Fund
Statements of Cash Flows
For the Years Ended June 30, 2008 and June 30, 2007
(Expressed in Thousands)

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Receipts from customers.....	\$ 127,021	\$ 116,381
Payments to employees.....	(41,874)	(37,582)
Payments to suppliers.....	(49,106)	(39,716)
Payments for interfund services used.....		(4,277)
Net cash provided by operating activities.....	<u>36,041</u>	<u>34,806</u>
Cash flows from capital and related financing activities:		
Proceeds from revenue bonds.....	27,175	89,214
Principal paid on bonds.....		(109)
Principal paid on revenue bonds.....	(3,472)	(55,208)
Acquisition and construction of capital assets.....	(55,310)	(58,808)
Capital contributions.....	13,859	23,160
Net cash used by capital and related financing activities.....	<u>(17,748)</u>	<u>(1,751)</u>
Cash flows from investing activities:		
Interest received	3,023	3,382
Interest paid	(11,415)	(10,818)
Proceeds from the sale and maturities of investments	4,277	
Net cash used by investing activities.....	<u>(4,115)</u>	<u>(7,436)</u>
Net increase in cash and cash equivalents.....	14,178	25,619
Cash and cash equivalents, beginning of year.....	145,967	120,348
Cash and cash equivalents, end of year.....	<u>\$ 160,145</u>	<u>\$ 145,967</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	<u>\$ 35,324</u>	<u>\$ 17,696</u>
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense.....	11,686	11,634
Changes in assets in liabilities:		
Accounts receivable.....	(4,212)	1,026
Inventories.....	(91)	(471)
Accounts payable and accrued liabilities.....	46	348
Other liabilities.....	376	271
Accrued interest payable.....	602	
Restricted accounts payable.....	(2,657)	4302
Due to other funds.....	(7,000)	
Due to other governments.....	1,967	
Total adjustments.....	<u>717</u>	<u>17,110</u>
Net cash provided by operating activities.....	<u>\$ 36,041</u>	<u>\$ 34,806</u>

The notes to the financial statements are an integral part of this statement.

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements
June 30, 2008

1. Description of the Water Utility

The Water Utility is a separate utility in the Bureau of Water and Waste Water, one of the three bureaus in the City of Baltimore, Maryland's Department of Public Works. In November 1978, the voters approved a Charter Amendment establishing the Water Utility as a separate enterprise and requiring it to be financially self-sustaining and operated without profit or loss to the other funds or programs of Baltimore City (City).

These financial statements are only of the Water Utility's operations and are not intended to present the financial position, changes in financial position, or, where applicable, cash flows of the City.

2. Summary of Significant Accounting Policies

The accounting and financial reporting policies of the Water Utility conform to accounting principles generally accepted in the United States and reporting standards as promulgated by the Governmental Accounting Standards Board for enterprise funds.

The Water Utility has elected not to follow Financial Accounting Standards Board pronouncements issued after November 30, 1989.

Basis of Accounting

The financial statements have been prepared on the accrual basis of accounting whereby revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Operating revenues result from the services provided by the Water Utility, and all other revenue is considered non-operating.

Cash and Cash Equivalents

Cash and cash equivalents include demand deposits, as well as short-term investments with a maturity date within three months of the date acquired by the Water Utility.

Investments

Investments are reported at fair value on the date of the Statement of Net Assets, based on market prices. Investments with maturities of less than one year from purchase date are reported at cost, which approximates fair value. Securities traded on national exchanges are valued at the last reported sales price.

Swaps

Interest Rate Swaps are entered into to take advantage of lower cost interest rates, through conversion of variable rate to fixed rates and fixed rate to variable rates. It is the policy of the Water Utility to not record the fair value of the swap arrangements. Swap related transactions are recorded as payments are received and made. Note 10 provides more information on the various rewards and risks typical to these types of financing arrangements.

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements
June 30, 2008

Inventories

Inventories are stated at cost, using the moving average cost method.

Unbilled Water Utility User Charges

Unbilled water user charges are estimated and accrued at year-end.

Restricted Assets

The proceeds of the Water Utility revenue bonds, Federal and State grants, and restricted accounts receivable are restricted for the purpose of the construction of water facilities and revenue bond repayment requirements.

Use of Restricted Net Assets

When an expense is incurred for which restricted and unrestricted resources are available to pay the expense, it is the Water Utility's policy to apply the expense first to restricted resources, then to unrestricted resources.

Capital Assets

Purchased or constructed capital assets are reported at historical cost. Capitalization thresholds are \$250,000 for buildings, improvements, and infrastructure; and \$5,000 for equipment.

Capital assets are depreciated using the straight-line method over the estimated useful lives, as follows:

Buildings.....	50 years
Improvements.....	20-50 years
Equipment.....	2-25 years
Mobile Equipment....	5-10 years

Amortization

Bond issuance costs are amortized over the life of the issue using the straight-line method, the effect of which is not materially different than under the effective interest method. Gains and losses on the early extinguishment of debt are amortized over the shorter of the life of the new or old debt.

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements
June 30, 2008

Sick, Vacation, and Personal Leave

Employees earn one day of sick leave for each completed month of service; there is no limitation on the number of sick leave days that may be accumulated. A portion of unused sick leave earned annually during each twelve-month period may be converted to cash for a maximum of three days, computed on an attendance formula.

Upon retirement with pension benefits, or termination of employment after completion of twenty or more years of service without pension benefits, employees receive one day's pay for every four sick leave days accumulated and unused as of the date of separation; under any other conditions of separation, unused sick leave is forfeited. At June 30, 2008, it is estimated that accumulated non-vested sick leave for the Water Utility approximated \$1,469,000. Sick leave benefit expenses are recorded as a percent of conversion value based on years of service, with a maximum of 100% for employees with twenty years or more of service.

Employees can accumulate a maximum of 224 vacation and personal leave days depending upon length of service, which may be taken either through time off or carried until paid upon termination or retirement. Accumulated vacation and personal leave expenses are recorded when leave is earned.

The total vacation, personal leave, and conversion value of unused sick leave recorded as a liability for compensated absences at June 30, 2008 and 2007 is \$5,108,000 and \$4,761,000, respectively.

3. Deposits and Investments

The Water Utility participates in the City's pooled cash account. At June 30, 2008 and 2007, the Water Utility's share of the City's pooled cash account, including both restricted and unrestricted cash, was \$82,516,000 and \$70,958,000, respectively. All of the City's pooled cash deposits are either insured through the Federal Depository Insurance Corporation or collateralized by securities held in the name of the City by the City's agent.

For other than pension funds, the City is authorized by state law to invest in direct or indirect obligations of the United States Government, repurchase agreements that are secured by direct or indirect obligations of the United States Government, certificates of deposit, commercial paper with highest letter and numerical rating, and mutual funds registered with the Securities and Exchange Commission. The City's investment policy limits the percentage of certain types of securities, with the exception of obligations for which the United States Government has pledged its full faith and credit. For investments held by the City in trust and/or to secure certain debt obligations, the City complies with the terms of the trust agreements. The City's Board of Finance has formally adopted the above policies and reviews and approves all security transactions.

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements
June 30, 2008

The Water Utility's investments at June 30, 2008 and 2007 are presented in the following table. All investments are presented by investment type, and debt securities are presented by maturity (amounts expressed in thousands):

June 30, 2008	Fair	<u>Investment Maturities (In Months)</u>		
Investment Type	Value	Less than 6	6 to 12	Greater than 12
Debt Securities:				
U.S. Agencies	\$ 22,084	\$ 22,084		
Money market mutual funds	50,831	50,831		
Commercial paper	4,714	4,714		
	<u>77,629</u>	<u>\$ 77,629</u>		
Less: Cash equivalents	<u>77,629</u>			
Total investments	<u><u> </u></u>			

June 30, 2007	Fair	<u>Investment Maturities (In Months)</u>		
Investment Type	Value	Less than 6	6 to 12	Greater than 12
Debt Securities:				
U.S. Agencies	\$ 3,250	\$ 3,250		
Repurchase agreements	4,277			\$ 4,277
Money market mutual funds	67,445	67,445		
Commercial paper	4,314	4,314		
	<u>79,286</u>	<u>\$ 75,009</u>		<u>\$ 4,277</u>
Less: Cash equivalents	<u>75,009</u>			
Total investments	<u><u>\$ 4,277</u></u>			

Interest rate risk – Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of investments. The City limits its interest rate risk in accordance with the City's Board of Finance policy by maintaining a minimum of 20 percent of the City's investment in funds in liquid investments, to include United States Government securities, and by limiting the par value of the portfolio invested for a period greater than one year at or below \$100 million. The Water Utility is in compliance with this policy.

Credit risk of debt securities – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. As discussed above, the City's Board of Finance limits City investments to only the highest rated investments in the categories discussed above. The Water Utility's portions of the City's rated debt investments as of June 30, 2008 and 2007 were rated by a nationally recognized statistical rating agency, and are presented below using the Standard and Poor's rating scale (amounts expressed in thousands):

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements
June 30, 2008

June 30, 2008		Quality Ratings	
Investment Type	Fair Value	AAA	A1 - P1
Debt Securities:			
U.S. Agencies	\$ 22,084	\$ 22,084	
Money market mutual funds:			
M&T Bank US Government Money Market Fund ...	50,831	50,831	
Commercial paper	4,714		\$ 4,714
Total rated debt investments	<u>\$ 77,629</u>	<u>\$ 72,915</u>	<u>\$ 4,714</u>

June 30, 2007		Quality Ratings	
Investment Type	Fair Value	AAA	A1 - P1
Debt Securities:			
U.S. Agencies	\$ 3,250	\$ 3,250	
Repurchase agreements:			
Underlying securities.....	4,277	4,277	
Money market mutual funds:			
M&T Bank US Government Money Market Fund ...	67,445	67,445	
Commercial paper	4,314		\$ 4,314
Total rated debt investments	<u>\$ 79,286</u>	<u>\$ 74,972</u>	<u>\$ 4,314</u>

Concentration of credit risk – Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The City has not adopted a formal policy on the concentration of credit risk.

The Water Utility had the following debt security investments at June 30, 2008 and 2007, that were more than five percent of total investments (amounts expressed in thousands):

June 30, 2008		Percentage of
Investment	Fair Value	Portfolio
Commercial paper – Morgan Stanley	\$ 4,714	6.1%

June 30, 2007		Percentage of
Investment	Fair Value	Portfolio
Commercial paper – Morgan Stanley	\$ 4,314	5.4%
Repurchase agreements – Lehman Securities.....	\$ 4,277	5.4%

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements
June 30, 2008

4. Allowance for Doubtful Accounts

Accounts receivable are shown net of a \$3,784,000 allowance for fiscal year 2008 and a \$4,043,000 allowance for fiscal year 2007.

5. Interfund Balances and Activity

Balances due to/from other funds at June 30, 2007 (amounts expressed in thousands):

<u>Fund</u>	<u>Interfund</u>	
	<u>Receivable</u>	<u>Payable</u>
Water		\$ 7,000
Waste Water	\$ 7,000	
Totals	<u>\$ 7,000</u>	<u>\$ 7,000</u>

The interfund balances reflect the fact that, at June 30, 2007, certain transactions between the Water and the Waste Water Utility Funds relating to capital financing had not been completed.

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6. Capital Assets

Capital assets activity for the years ended June 30, 2008 and 2007 was as follows (expressed in thousands):

	Balance June 30, 2007	Increases	Decreases	Balance June 30, 2008
Capital assets not being depreciated:				
Land	\$ 12,540			\$ 12,540
Construction in progress	364,580	\$ 67,108	\$ 13,930	417,758
Total capital assets not being depreciated	<u>377,120</u>	<u>67,108</u>	<u>13,930</u>	<u>430,298</u>
Capital assets being depreciated:				
Buildings and improvements	630,606			630,606
Equipment	53,899	2,131		56,030
Total capital assets being depreciated	<u>684,505</u>	<u>2,131</u>		<u>686,636</u>
Less: accumulated depreciation for:				
Buildings and improvements	(290,740)	(9,829)		(300,569)
Equipment	(42,595)	(1,856)		(44,451)
Total accumulated depreciation	<u>(333,335)</u>	<u>(11,685)</u>		<u>(345,020)</u>
Total capital assets being depreciated, net	<u>351,170</u>	<u>(9,554)</u>		<u>341,616</u>
Total capital assets, net	<u>\$ 728,290</u>	<u>\$ 57,554</u>	<u>\$ 13,930</u>	<u>\$ 771,914</u>
	Balance June 30, 2006	Increases	Decreases	Balance June 30, 2007
Capital assets not being depreciated:				
Land	\$ 12,540			\$ 12,540
Construction in progress	296,144	\$ 82,324	\$ 13,888	364,580
Total capital assets not being depreciated	<u>308,684</u>	<u>82,324</u>	<u>13,888</u>	<u>377,120</u>
Capital assets being depreciated:				
Buildings and improvements	629,685	921		630,606
Equipment	52,802	1,097		53,899
Total capital assets being depreciated	<u>682,487</u>	<u>2,018</u>		<u>684,505</u>
Less: accumulated depreciation for:				
Buildings and improvements	(280,861)	(9,879)		(290,740)
Equipment	(40,840)	(1,755)		(42,595)
Total accumulated depreciation	<u>(321,701)</u>	<u>(11,634)</u>		<u>(333,335)</u>
Total capital assets being depreciated, net	<u>360,786</u>	<u>(9,616)</u>		<u>351,170</u>
Total capital assets, net	<u>\$ 669,470</u>	<u>\$ 72,708</u>	<u>\$ 13,888</u>	<u>\$ 728,290</u>

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Interest is capitalized on capital assets acquired with tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest cost incurred from the date of the borrowing until completion of the project, with interest earned on invested proceeds over the period. During fiscal years 2008 and 2007, interest cost of \$8,765,000 and \$8,193,000, respectively (net of interest earned of \$ 3,023,000 and \$3,756,000, respectively), was capitalized.

At June 30, 2008, the Water Utility had outstanding commitments for construction of \$52,185,000.

7. Long-term Obligations

The Constitution of Maryland requires a three-step procedure for the creation of debt by the City of Baltimore:

- Act of the General Assembly of Maryland or resolution of the majority of Baltimore City delegates
- Ordinance of the Mayor and City Council of Baltimore
- Ratification by the voters of the City of Baltimore

Changes in long-term debt obligations for the years ended June 30, 2008 and 2007 are as follows (amounts expressed in thousands):

	Balance June 30, 2007	Additions	Reductions	Balance June 30, 2008	Amounts Due Within One Year
General obligation bonds payable (a).....	<u>\$ 855</u>	<u>\$ 42</u>		<u>\$ 897</u>	
Revenue bonds	\$ 426,655	\$ 27,175	\$ 3,773	\$ 450,057	
Less: unamortized charges	<u>8,082</u>		<u>259</u>	<u>7,823</u>	
Total Revenue bonds payable	<u>\$ 418,573</u>	<u>\$ 27,175</u>	<u>\$ 3,514</u>	<u>\$ 442,234</u>	<u>\$ 3,273</u>
Compensated absences	<u>\$ 4,761</u>	<u>\$ 347</u>		<u>\$ 5,108</u>	<u>\$ 3,720</u>

	Balance June 30, 2006	Additions	Reductions	Balance June 30, 2007	Amounts Due Within One Year
General obligation bonds payable (a)....	<u>\$ 1,005</u>	<u>\$ 44</u>	<u>\$ 194</u>	<u>\$ 855</u>	
Revenue bonds	\$ 387,805	\$ 93,260	\$ 54,410	\$ 426,655	
Less: unamortized charges	<u>7,297</u>	<u>1,016</u>	<u>231</u>	<u>8,082</u>	
Total Revenue bonds payable	<u>\$ 380,508</u>	<u>\$ 92,244</u>	<u>\$ 54,179</u>	<u>\$ 418,573</u>	<u>\$ 3,119</u>
Compensated absences	<u>\$ 4,571</u>	<u>\$ 190</u>		<u>\$ 4,761</u>	<u>\$ 3,719</u>

(a) The general obligation bonds bear interest at rates ranging from 4.7% to 7.5% and mature serially through 2011.

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The following is a schedule of the principal and interest payments required as of June 30, 2008 to service the general obligation bond debt payable by the Water Utility until maturity (amounts expressed in thousands):

	<u>General Obligation</u>	
	<u>Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2010.....	\$ 790	\$ 50
2011.....	107	12
Total.....	<u>\$ 897</u>	<u>\$ 62</u>

The City has issued revenue bonds, the proceeds of which were used to provide funds for capital improvements to water facilities. Assets with a carrying value of \$40,961,000 at June 30, 2008, and certain revenues of the Water Utility are pledged as collateral for the bonds and notes. Bonds and notes outstanding as of June 30 consist of (amounts expressed in thousands):

	<u>2008</u>	<u>2007</u>
Serial bonds series 1993-A maturing in annual installments from \$1,815,000 to \$2,125,000 through July 1, 2008, with interest ranging from 5.1% to 5.5%, payable semiannually.....	\$ 2,125	\$ 4,140
Serial bonds series 1994-A maturing in annual installments from \$700,000 to \$850,000 through July 1, 2009, with interest ranging from 4.6% to 5.0%, payable semiannually.....	1,660	2,435
Serial bonds series 2002-A maturing in annual installments from \$1,855,000 to \$1,975,000 from July 1, 2009 through July 1, 2021, with variable interest through July 1, 2016 and a fixed rate of 4.85 –5.0% thereafter payable semiannually.....	24,600	24,600
Serial bonds series 2003-B maturing in annual installments from \$66,000 to \$984,000 through February 1, 2024, with interest rate at 0.40% payable semiannually	1,581	1,831
Serial bonds series 2004-A maturing in annual installments from \$197,000 to \$984,000 through February 1, 2024, with interest rate at 0.45% payable semiannually	4,989	5,659
Serial bonds series 2005-A maturing in annual installments from \$3,500,000 to \$580,000 from July 1, 2021 through July 1, 2025, with interest rate of 4.0% to 5.0%, payable semiannually.....	1,670	1,670
Term bonds series 1993-A with interest at 5.6%, payable semiannually, due July 1, 2013.....	12,200	12,200
Term bonds series 1993-A with interest at 5.65%, payable semiannually, due July 1, 2020.....	23,900	23,900
Term bonds series 1994-A with interest at 6.0%, payable semiannually, due July 1, 2015.....	6,250	6,250

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	<u>2008</u>	<u>2007</u>
Term bonds series 1994-A with interest at 5.0%, payable semiannually, due July 1, 2024.....	10,280	10,280
Term bonds series 2002-A with interest at 5.0%, payable semiannually, due July 1, 2023.....	4,250	4,250
Term bonds series 2002-A with interest at 5.0%, payable semiannually, due July 1, 2027.....	9,845	9,845
Term bonds series 2002-A with interest at 5.125%, payable semiannually, due July 1, 2032.....	15,385	15,385
Term bonds series 2002-A with interest at 5.125%, payable semiannually, due July 1, 2042.....	64,840	64,840
Auction rate notes series 2002-B, payable monthly, due July 1, 2037.....	18,300	18,300
Auction rate notes series 2002-C, payable monthly, due July 1, 2037.....	40,800	40,800
Term bonds series 2003-A with interest at 4.2%, payable semiannually, due July 1, 2028	12,835	12,835
Auction Rate Notes Series 2004-B, payable weekly, due July 1, 2034	47,500	47,500
Serial bonds series 2006-A maturing in annual installments from \$515,000 to \$1,035,000 from July 1, 2009 through July 1, 2026, with interest rate of 4.0% to 4.5%, payable semiannually.....	13,310	13,310
Term bonds series 2006-A with interest at 4.625%, payable semiannually, due July 1, 2031	5,930	5,930
Term bonds series 2006-A with interest at 4.625%, payable semiannually, due July 1, 2036	7,435	7,435
Serial bonds series 2007-A maturing in annual installments from \$64,000 to \$80,000 from July 1, 2009 through February 1, 2037, with interest rate at 0.40%, payable semiannually.....	2,182	2,245
Serial bonds series 2007-B maturing in annual installments from \$30,000 to \$3,860,000 from July 1, 2009 through July 1, 2027, with interest rates of 3.6% to 4.5%, payable semiannually.....	19,835	19,835
Term bonds series 2007-B with interest at 4.5%, payable semiannually, due July 1, 2032	22,995	22,995
Term bonds series 2007-B with interest at 4.5%, payable semiannually, due July 1, 2035	7,910	7,910

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	<u>2008</u>	<u>2007</u>
Serial bonds series 2007-C maturing in annual installments from \$740,000 to \$1,570,000 from July 1, 2010 through July 1, 2027, with interest rates of 3.75% to 5.0%, payable semiannually.....	19,530	19,530
Term bonds series 2007-C with interest at 5.0%, payable semiannually, due July 1, 2032	9,115	9,115
Term bonds series 2007-C with interest at 5.0%, payable semiannually, due July 1, 2037	11,630	11,630
Serial bonds series 2008-A maturing in annual installments from \$475,000 to \$1,005,000 from July 1, 2009 through July 1, 2028, with interest rates of 2.00% to 4.50%, payable semiannually.....	14,170	
Term bonds series 2008-A with interest at 4.625%, payable semiannually, due July 1, 2033.....	5,740	
Term bonds series 2008-A with interest at 4.73%, payable semiannually, due July 1, 2038.....	1,115	
Term bonds series 2008-A with interest at 5.00%, payable semiannually, due July 1, 2038	6,150	
	<u>450,057</u>	<u>426,655</u>
Less: unamortized charges	7,823	8,082
	<u>\$442,234</u>	<u>\$418,573</u>

At June 30, 2008, the Water Utility fund had \$106,600,000 of auction rate notes outstanding. Interest rates for these notes are determined every 7 to 35 days depending on the date of issue. In the event of a failed auction, the auction agent assesses the failed auction rate to the issuers of the notes. Interest paid under these conditions is currently limited to 150% to 175% of the non-financial commercial paper rate depending on the rating of the insurance provider on each note issue. At December 31, 2008 the failed auction rate on these notes is in the 1% range or less.

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Principal maturities and interest on revenue bonds are as follows (amounts expressed in thousands):

Fiscal Year	Principal	Interest	Interest Rate Swap Net (a)
2009.....	\$ 3,273	\$ 20,276	\$ 2,922
2010.....	6,264	20,574	2,950
2011.....	7,666	20,212	2,999
2012.....	8,542	19,791	3,030
2013	9,024	19,336	3,052
2014 to 2018	52,708	89,036	15,301
2019 to 2023.....	65,273	74,924	13,588
2024 to 2028.....	71,354	59,982	10,793
2029 to 2033.....	91,757	42,360	7,179
2034 to 2038.....	87,506	20,919	1,863
2039 to 2042.....	46,690	6,058	(251)
	<u>\$450,057</u>	<u>\$393,468</u>	<u>\$ 63,426</u>

- (a) Interest rate swap net payments represent estimated payments for additional interest resulting from swap agreements to counterparties. The additional payments were computed using interest rates as of June 30, 2008, assuming current interest rates remain the same for the entire term of the bonds. As rates vary, variable rate bond interest payments and net swap payments will vary.

The Water Utility has various revenue bond covenants that generally require the Utility to maintain rates sufficient to meet the operating requirements of the Utility and an operating reserve as defined in the revenue bond indentures. As of June 30, 2008, the rate requirements were met, and management believes the Water Utility is in compliance with all significant requirements of the indentures.

8. Pledged Revenue

The Water Utility Fund has pledged future customer revenues to repay \$450,057,000 of revenue bond debt. Proceeds from these revenue bonds were used to build and improve various aspects of the City's Water Utility system. The bonds are payable solely from the revenues of the Water Utility Fund and are payable through 2042. Annual principal and interest payments on these revenue bonds are expected to require 16% of pledged revenues. Total principal and interest remaining to be paid on the revenue bonds for the Water Utility Fund is \$906,951,000. Principal and interest paid for the current year and current pledged revenue for the Water Utility Fund was \$20,052,000 and \$131,233,000, respectively.

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9. Prior-Year Defeasance of Debt

In prior years, the Water Utility defeased certain revenue bonds by placing the proceeds of new debt issues in an irrevocable trust to provide for all future debt service payments on the old debt. Accordingly, the trust account assets and the liability for the defeased debt are not included in the Water Utility's financial statements. At June 30, 2008, \$165,680,000 of debt outstanding is considered defeased.

10. Interest Rate Swaps

Objectives of the swaps - The City has entered into swaps for three reasons: First, the majority of its swaps have been used to create synthetic fixed rate financings (by issuing floating-rate bonds and swapping them to fixed) as a way to provide lower-cost fixed rate financing to meet the City's capital needs. Second, the City has used swaps from fixed to floating to help the City manage its balance sheet for an appropriate mix of fixed and floating rate exposure. And, third, the City has used basis swaps to amend the floating rate on certain of its existing synthetic fixed rate swaps in order to provide a better hedge on the underlying floating rate bonds.

Terms, fair value, and credit risk - The terms, fair values and credit risk ratings of the outstanding swaps, as of June 30, 2008, were as follows. The notional amounts of the swaps match the principal amount of the associated debt. The City's swap agreements contain scheduled reductions to outstanding notional amounts that are designed to track the scheduled or anticipated reductions in the associated "bonds payable" category.

Outstanding Bonds	Effective Date	Termination Date	Interest Rate Paid by City	Interest Rate Received	Notional Amount	Fair Value	Counterparty Credit Rating
<i>Fixed to Floating Swaps:</i>							
1993 Revenue Bonds	1/1/2008	7/1/2020	SIFMA Index	5.54%	\$ 4,276,748	\$ (870,470)	AA/Aa2
1994 Revenue Bonds	1/1/2008	7/1/2024	SIFMA Index	5.26%	4,108,595	(136,719)	AA/Aa2
1998 Revenue Bonds	2/1/2001	7/1/2027	SIFMA Index	5.17%	24,695,000	555,766	AA/Aa2
1998 Revenue Bonds	7/1/2008	7/1/2028	SIFMA Index	5.08%	1,927,360	(92,126)	AA/Aa2
2000 Revenue Bonds	7/1/2003	7/1/2030	SIFMA Index	5.70%	2,907,750	(63,618)	AA/Aa2
<i>Floating to Fixed Swaps:</i>							
1998 Revenue Bonds	10/26/2001	7/1/2008	5.17%	SIFMA Index	* 24,695,000	(363,282)	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2037	4.555%	SIFMA/67% LIBOR	59,100,000	(9,883,688)	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2009	3.87%	Bond Rate/CPI	1,855,000	46,551	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2010	4.00%	Bond Rate/CPI	1,900,000	52,138	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2011	4.10%	Bond Rate/CPI	1,955,000	61,478	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2012	4.20%	Bond Rate/CPI	2,110,000	67,366	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2013	4.30%	Bond Rate/CPI	2,170,000	70,474	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2014	4.39%	Bond Rate/CPI	2,325,000	62,306	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2015	4.50%	Bond Rate/CPI	1,615,000	31,373	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2016	4.61%	Bond Rate/CPI	1,685,000	26,997	A+/Aa3
2004 Revenue Bonds	6/1/2004	7/1/2034	5.21%	SIFMA Index	47,500,000	(8,433,351)	A+/Aa3
<i>Basis Swap:</i>							
2002 Revenue Bonds	4/20/2005	7/1/2042	SIFMA	67% LIBOR+20bps	71,455,000	(6,984,482)	AAA/Aaa
Grand Total Swaps Outstanding					<u>* \$256,280,453</u>	<u>\$(25,853,287)</u>	

* Note: Notional principal total includes a swap that amended or partially reversed another swap previously entered into by the City. If this offsetting and amended swap is excluded, the notional principal total would be lower as follows: \$231,585,453.

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Credit risk - As of June 30, 2008, the City is exposed to credit risk on nine of the outstanding swaps because all of the other swaps have negative fair values. All fair values were calculated using the mark-to-market or par value method. However, should interest rates change and the fair values of the swaps become positive, the City would be exposed to credit risk in the amount of the derivatives' fair value. For the nine swap agreements that have positive fair value, the City has credit exposure to the counterparties as of June 30, 2008. Should the counterparties to these transactions fail to perform according to the terms of the swap contracts, the City faces a maximum loss equivalent to the swaps' \$974,449 fair value. However, because the swaps' counterparties are also party to other swaps whose fair value is currently negative, the City could use netting provisions to offset the potential loss.

The swap agreements contain varying collateral agreements with counterparties. In general, these agreements require full collateralization of the fair value of the swap should the counterparty's credit rating fall below Baa as issued by Moody's or BBB as issued by Standard and Poor's. Collateral on all swaps is to be in the form of United States Government securities held by the City.

Although the City executes transactions with various counterparties, 11 swaps, approximating 58% of the notional amount of swaps outstanding, are held with one counterparty. That counterparty is rated A+/Aa3. The City holds another five swaps, approximating 14% of the notional amount of swaps outstanding, with a counterparty rated AA/Aa2. The remaining swap, approximating 28% of the outstanding notional value, is held with a counterparty rated AAA/Aaa.

Basis risk - The City's variable rate bonds are of three types: remarketed variable rate demand bonds ("VRDBs"), auction rate bonds ("ARBs"), and CPI index bonds. For those swaps associated with the VRDBs and ARBs, the City receives a floating rate based on either the SIFMA Index or the one-month LIBOR. For the SIFMA based swaps, the City is exposed to basis risk should the spread between the SIFMA and the VRDBs or ARBs rate change. If a change occurs that results in the spread widening, the expected cost savings may not be realized. As of June 30, 2008, the SIFMA rate for the 52-week period ranged from 1.24% to 3.95%, whereas the City tax-exempt market ranged from 1.15% to 6.10%. For one of the swaps, the City will receive 67% percent of LIBOR, a rate chosen to closely approximate the City's tax-exempt variable rate bond payments. Because this swap is LIBOR-based, there is an additional degree of basis risk. As of June 30, 2008, 67% of LIBOR for the 52-week period ranged from 2.56% to 5.82%. For those swaps associated with CPI index bonds, there is no basis risk, because the floating rate on the swaps is identical to the floating rate on the bonds.

Interest rate risk - For those swaps for which the City pays a floating rate and receives fixed rate payments, the City is exposed to interest rate risk. As floating rates increase, the City's expected savings could decrease. The City would, however, benefit from offsetting

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increases in its earnings on short-term investments, whose return would be expected to go up in a higher interest rate environment.

Termination risk - The City or the counterparty may terminate a swap if the other party fails to perform under the terms of the contract. If at the time of termination the swap contract has a negative fair value, the City would be liable to the counterparty for that payment.

New Accounting Pronouncement - In June 2008, the GASB issued Statement No. 53, "Accounting and Financial Reporting for Derivative Instruments." GASB Statement No. 53 will require that derivative instruments be reported at fair value; further, periodic changes in those fair values for investment derivatives or other derivatives which are ineffective will be reported as a component of investment income. For derivatives which are effective hedging instruments, periodic changes in fair value will be deferred on the statement of net assets. GASB Statement No. 53 is effective July 1, 2009 for the Fund's financial statements for the fiscal year ending June 30, 2010.

11. Pension Plan

Classified employees of the Water Utility are required to join the City of Baltimore's Employees' Retirement System (ERS). The ERS is a cost-sharing multiple-employer defined benefit pension plan which provides retirement, disability and death benefits to plan members and beneficiaries. The plan is managed by a Board of Trustees in accordance with Article 22 of the Baltimore City Code. Plan provisions may be amended only by the City Council. The Water Utility's share of contributions to the plan was \$3,172,000 in 2008, \$2,668,000 in 2007, and \$2,353,000 in 2006. The Water Utility contributed 100% of the required contribution each of the three years. ERS issues a publicly available financial report that may be obtained by writing to the Baltimore City Retirement Systems, 7 East Redwood Street, 12th Floor, Baltimore, MD 21202-3470.

12. Other Postemployment Benefits

Baltimore City administrative policy provides that other postemployment benefits, other than pension benefits, be provided to all employees of the City. These benefits include certain healthcare and life insurance benefits. All employees who retire are eligible to receive these benefits. The City of Baltimore provides other postemployment benefits (OPEB) to all qualified City employees. The OPEB Plan (Plan) is a contributory, single employer defined benefit plan. The benefit and contribution provisions of the Plan are established and may be amended by the City. The Plan provides postemployment healthcare, prescription and life insurance benefits to retirees and their beneficiaries. In order to effectively manage the Plan, the City established an OPEB Trust Fund. All retiree and City contributions are deposited into the Trust Fund and all retiree related health and life insurance benefits are paid from the Trust Fund. The City also contracted with the Board of Trustees of the Employees' Retirement System to act as investment manager for the Trust Fund. BNY Mellon Bank Asset Servicing is the Trust Fund's asset

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custodian. The Plan does not issue stand alone financial statements: however, the OPEB Trust Fund is included in the City's financial statements as a Trust and Agency Fund.

At June, 2008, there were 21,017 City retirees eligible for these benefits. The City reimburses approximately 50% of the premium cost incurred by pre-Medicare retirees and dependents. The City also reimburses approximately 50% of the cost for Medicare supplement for each retiree or dependent eligible for Medicare. Such benefits are accounted for on a cash basis so that payments during the current year represent benefit coverage for the currently retired employees or their beneficiaries.

For fiscal year 2008, the City's total contributions to the Plan were \$183.3 million from its General Fund.

13. Risk Management

The Water Utility participates in the City's risk management program. The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During fiscal year 1987, the City established the Risk Management Fund (an internal service fund) to account for and finance its uninsured risks. The City's risk financing techniques include a combination of risk retention through self-insurance and risk transfer through the purchase of commercial insurance. The Risk Management Fund services all claims for risk of loss, including general liability, property and casualty, workers' compensation, unemployment compensation, automobile physical damage and bodily injury, and sundry other risks. Commercial insurance coverage is provided for each property damage claim in excess of \$750,000 with a cap of \$250,000,000. Settled claims have not exceeded this commercial coverage in any of the past three years. The City also provides medical insurance coverage for all employees and retirees. Employees are required to pay a percentage of the annual cost of the medical plans, and the remaining costs are paid by the City's internal service fund.

All funds of the City participate and make payments to the Risk Management Fund based on actuarial estimates and historical cost information of the amounts needed to pay prior and current year claims. During fiscal years 2008 and 2007, the Water Utility's share of the City's cost was \$8,138,000 and \$7,628,000, respectively.

14. Commitments and Contingencies

The Water Utility has received Federal and State grants. Entitlement to grant resources is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable Federal and State regulations, including the expenditure of the resources for eligible purposes. Substantially all grants are subject to financial and compliance audits in accordance with grantors' requirements. Any disallowances as a result of these audits become a liability of the Water Utility. As of June 30, 2008, the Water Utility estimates that no material liabilities will result from such audits.

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The City has voluntarily entered into a Consent Decree to rehabilitate its aging sewer infrastructure and correct historical overflow mechanisms. The Consent Decree is one of many that the United States Department of Justice has currently negotiated with major east coast cities with aged sewer and storm water infrastructures. The City is proactively negotiating to increase its remedial efforts to address discharge and overflow concerns of the State and Federal regulatory agencies. These efforts are ambitious, and the costs of the construction and maintenance are estimated to range between \$500 to \$700 million dollars over the next decade and beyond. The City has committed to financing these remedial efforts through a combination of water and waste water revenue bonds in conjunction with all available State and Federal assistance.